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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 Rate Regulation Leased Commercial Access	 MM Docket No. 92-266 CS Docket No. 96-60

REPLY COMMENTS OF TELE-COMMUNICATIONS, INC.

TELE-COMMUNICATIONS, INC.

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SUMMARY

The Comments submitted in this proceeding confirm that the rate formula proposed in the *NPRM* ignores the most critical "opportunity cost" of devoting limited cable capacity to commercial leased access. The economics of cable programming virtually guarantee that leased access programming will be dominated by direct sales services and/or services of vastly inferior quality. Leased access activity will, therefore, necessarily have an adverse effect on subscriber satisfaction and subscriber revenue. Section 612 requires that leased access rates be set to reflect this fact.

TCI supports adoption of NCTA's proposed rate formula. The "average channel rate plus markup" approach recognizes the negative ramifications of converting cable channels to leased access use. The "rate averaging" approach, coupled with an appropriate negotiation period, would allow operators to increase the value and diversity of leased access programming.

Finally, TCI urges the Commission to ensure that any dispute resolution mechanisms adopted restrict the ability of leased access applicants to unfairly burden or harass cable operators or to jeopardize confidential information. Consistent with Section 612, the burdens of a rate challenge should fall primarily on the leased access applicant, not the cable operator.

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REPLY COMMENTS OF TELE-COMMUNICATIONS, INC.

Tele-Communications, Inc. ("TCI"), by its attorneys, hereby submits these Reply Comments in the above-referenced proceeding. In its Comments, TCI established that the "opportunity cost" formula advanced in the *Notice of Proposed Rulemaking* ("*NPRM*") fails to attribute any value to TCI's most important asset -- the ability to program cable channels for their highest and best use. The Comments of other parties filed in this proceeding confirm TCI's analysis. They also confirm the need to impose reasonable restrictions on the use of leased access to protect the interests of cable operators, conventional cable programmers, and, most importantly, cable subscribers.

I. THE PROPOSED LEASED ACCESS RATE IS UNREASONABLY LOW BECAUSE IT IGNORES CABLE'S MOST IMPORTANT OPPORTUNITY COST.

The *NPRM* focuses on the "tangible" costs associated with converting existing cable channels to leased access programming (*i.e.*, lost advertising revenue vs. reduced programming fees) and dismisses the negative effect such conversion would have on subscriber revenue as "speculative." Not surprisingly, leased access advocates generally support the Commission's approach, but they do so without any factual support or analysis.[1] Their cavalier dismissal of the impact cable programming has on cable subscribership and the perceived value of cable service is inconsistent and irreconcilable with the compelling evidence now in the record regarding the magnitude and importance of this factor.

TCI itself submitted a survey showing that an increase in leased access activity would decrease subscriber satisfaction and lead to a dramatic reduction in subscriber revenue.[2] Continental Cablevision submitted a survey showing very similar results.[3] Numerous cable operators and programmers filed Comments explaining the close relationship between high quality programming and subscriber satisfaction. Several prominent economists concurred and emphasized that a cable channel will have "spillover" effect beyond the value of the discrete channel.[4] Their message is supported by simple common sense. If high quality

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[1]*See, e.g.,* Comments of ValueVision International, Inc. ("Valuevision Comments") at 7 (cable operators will not be hurt by the replacement of conventional cable programming with leased access programming, because subscribers do not care about the particular channels likely to be replaced); Comments of United Broadcasting Corp., d/b/a Telemiami ("Telemiami Comments") at 3-5 and n. 3 (endorsing new formula but arguing that it is "unfair" to require leased access users "to pay any portion of an operator's operating costs, when no other type of programmer does so"); Comments of The Game Show Network, L.P. ("Game Show Comments") at 6-7 (endorsing new formula) and 10-11(arguing that "there is no reliable statistical method whereby a cable operator could ascribe lost or gained subscribers to a single event affecting tier programming").

[2]Comments of Tele-Communications, Inc ("TCI Comments"), Attachment G (Leased Access Programming Issues Survey).

[3]Comments of Continental Cablevision, Inc. ("Continental Comments"), Attachment 2 (Survey of Broward Co. Subscribers).

[4]*See, e.g.,* Stanley M. Besen and E. Jane Murdoch, *An Economic Analysis of the FCC's Cable Leased Access Proposal* (Charles River Associates, May 15, 1996) at 11-14 (Attachment A to TCI Comments); Economists Incorporated, *An Analysis of the Federal*

programming is replaced with low quality programming, and if popular entertainment programming is replaced by excessive shopping and infomercial programming, logic dictates that both cable subscribers' perception of the value of cable service and subscriber revenue will be adversely affected.

Several of the leased access advocates, arguing against compensating cable operators for subscriber loss, unintentionally undermine their own position by overreaching. They claim that leased access programming will increase, rather than decrease, subscriber satisfaction, thereby acknowledging the obvious link between cable subscribership and the quality and type of cable programming offered.[5] But they have no meaningful rebuttal to the overwhelming evidence in this proceeding that the quality and type of programming offered by leased access users will be inferior to that of conventional programmers.[6]

Communications Commission's Maximum Reasonable Leased Commercial Access Rate (May 15, 1996) at 15 (Attachment A to Comments of the National Cable Television Association ("NCTA Comments")); A. Daniel Kelley, *An Economic Analysis of Commercial Leased Access Pricing,* (Hatfield Associates, Inc., May 15, 1996) at 14 (Attached to Comments of Time Warner Cable ("Time Warner Cable")). *See also* Continental Comments, Attachment 1 (Affidavit of Robert A. Stengel) at ¶¶ 16-31.

[5] *See, e.g.,* Comments of Center for Media Education, *et al.,* at 8 n.10 ("Leased access programming actually *adds value* to the cable subscription because subscribers do not differentiate between leased access programming and programming provided by the cable operator; therefore, the addition of these channels produces revenue for the cable operator *through increased subscriber penetration,* at the same time that the operator collects payments from programmers for carriage.") (emphasis in original); Game Show Comments at 11 n.21 ("GSN is confident that adding GSN to a cable operator system would add more subscribers than would be lost by displacing current programming."); Comments of R.K. Production Co. at 5 (leased access programming is more likely to promote growth and development of a cable system than conventional programming "because it gives subscribers what they want").

[6] *See* discussion in Part A below.

Unfortunately, even a minor reduction in existing or potential subscribership would have major financial ramifications for cable operators. Time Warner demonstrated in its Comments that a 2.5% subscribership loss (well below the loss predicted by the surveys submitted by TCI and Continental) will result in lost income to the cable operator equal to 57 cents per month for each remaining subscriber.[7] Any leased access formula will seriously undervalue the "opportunity cost" of leased access channels if it does not account for the subscriber revenue ramifications of accommodating leased access programming.

A. **Conventional Programming and Commercial Leased Access Programming Are Not of Equal Quality and Type**

The record now shows that conventional cable programmers spend millions of dollars on their product to ensure its quality, popularity and wide distribution.[8] The record also shows that these programmers finance their operations through a combination of advertising revenue and licensing fees.[9] This dual revenue stream is essential to their

[7]Comments of Time Warner Cable at 16.

[8]*See, e.g.*, Comments of Outdoor Life Network, *et al.*, Attachment 1 (Affidavit of Roger Williams) at ¶¶13-15 (New Outdoor Life program service will spend in excess of $15 million in its first year of operation to produce and acquire original programming, and even more in successive years. New Speedvision program service will spend in excess of $17 million on original programming in its first year and estimates that it will spend $20 million each year thereafter. Typical three hour live event on Speedvision costs between $150,000 and $200,000 to produce.) *See also* Comments of The Travel Channel ("Travel Channel Comments") at 7 (Travel Channel has invested over $21 million in the last four years to develop its service); Comments of Discovery Communications, Inc. ("Discovery Comments") at 2 (Production costs of Peabody Award winning original documentary, "Normandy: The Great Crusade," was $1.5 million).

[9]*See, e.g.*, Continental Comments, Attachment 1 (Affidavit of Robert A. Stengel) at ¶¶20-22; Travel Channel Comments at 7; TCI Comments, Attachment B (Affidavit of Madison Bond) at ¶6.

viability. It explains why leased access applicants (who pay the operator to be carried as opposed to the other way around) typically must keep their production costs to an absolute minimum (thereby reducing quality) and/or devote the bulk of their programming to direct sales.

TCI agrees with the many conventional programmers who described in their Comments the underlying economic problem with commercial leased access. Discovery, for instance, explained, "A channel leasing model typically will be most viable only where the programmer has low programming costs...or a combination of a low cost format and another revenue stream."[10]

Ironically, the leased access advocates themselves attest to the underlying economic problem with commercial leased access. ValueVision's comments, for example, include a report by Media Group Research ("MGR") confirming that a reduction in leased access rates will be a windfall for shopping channels and do little to enhance the production and distribution of diverse programming.[11] The MGR Report analyzes the proposed leased access rate and concludes, "We expect significant activity from home shopping/infomercial providers . . . but probably little or no activity related to launch of traditional full-time subscription services . . . . [T]he leased access phenomenon will significantly reduce the

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[10]Discovery Comments at 9. *See also* Travel Channel Comments at 3 (Commercial leased access "produces programming that consumers do not value"); Comments of The International Cable Channel Partnership, Ltd. at 3 ("A formula which assigns virtually no value to channel capacity is necessarily flawed and exposes cable operators and subscribers to poorly-conceived, undercapitalized and disorganized local access ventures.")

[11]ValueVision Comments, Attachment A at 6 (acknowledging that direct marketers (i.e., home shopping/infomercials) are likely to be dominant users of leased access).

number of successful advertiser supported networks under traditional affiliate associations, and only those few with the right economic structure [*i.e.*, low production costs] will thrive."[12]

Leased access advocate Telemiami concurs. It warns that unless the Commission imposes safeguards, reduced leased access rates will "foster[] the conversion of leased access channels into nothing but home shopping and adult outlets. This is not the type of diversification of viewpoints the Cable Act is intended to promote."[13] Leased access advocate Lorilei Communications (an infomercial provider) reaches much the same conclusion about the likely composition of leased access programming. It notes that recent technological advances enable anyone with $100,000 to acquire a studio facility to produce cable programming.[14] There is, however, a huge difference between this relatively modest investment and the tens of millions of dollars typically invested by conventional start-up cable networks.[15] The Commission cannot possibly believe that subscribers will be indifferent to

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[12]Valuevision Comments, Attachment A at 1, 6.

[13]Telemiami Comments at 14.

[14]Comments of Lorilei Communications at 16.

[15]Interestingly, a number of programmers, who arguably might benefit from subsidized leased access terms, filed comments in this proceeding explaining why such terms would be counterproductive and reduce the amount of quality programming on cable. *See, e.g.*, Comments of Eternal Word Television Network, Inc. at 12; Comments of Shop At Home, Inc. at 1-2; Comments of PBS Horizons Cable at 3-4(Commission's proposals "may sacrifice the rich information diversity that a programmer like Horizons could bring to viewers through the traditional economic incentive structure of cable. If the FCC favors those programmers, like home shopping channels or program length commercial channels filled with 'infomercials,' whose economics might work under the FCC's proposed scheme, Horizons will suffer.")

the variations in programming quality resulting from such dramatically different production expenditures.[16]

B. The Proposed Leased Access Rates Would Improperly Subsidize Leased Access Users.

When all is said and done, there can be little doubt that the leased access rate proposed in the *NPRM*, by failing to account for the true value of a cable channel, would amount to a substantial subsidy for leased access users. Numerous Commenters noted that the proposed formula actually would produce a negative leased access rate in many cases. That result is patently absurd. Equally absurd is the "nominal" $.01 to $.10 fees advanced by various leased access advocates, without benefit of any justification beyond the fact that this amount is what they are willing to pay.[17] Cable operators cannot be required to provide leased access at a rate that leased access users can afford, if that rate is not fully compensable.[18]

The Game Show Network, an ardent supporter of reduced leased access rates, implicitly acknowledges the subsidy inherent to the Commission's proposed formula. It notes

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[16]Congress recognized the importance of high programming expenditures in the leased access context by limiting the special set-aside for "qualified educational programming sources" to those with a "documented annual expenditure on programming exceeding $15,000,000." 47 U.S.C. § 532(i)(3).

[17]*See, e.g.*, ValueVision Comments, Attachment A (MGR Report) at 2 ("well run" home shopping channel might be able to afford $.10 per sub; rate of less than $.05 would be needed to "stimulate activity" by advertiser supported networks with "the right economic structure" (i.e., low cost/high profit)).

[18]Continental showed that in strict cost terms (leaving aside the critical "opportunity costs" of the channel and its impact on the overall cable product), a channel costs the company $0.87 per subscriber per month. Continental Comments at 23 and Attachment 4.

that if the revised cost formula is implemented, "the cable television industry may experience the modern-day equivalent of the Oklahoma land rush."[19] That is, of course, precisely TCI's concern. Leased access was **not** intended as a "modern-day" government hand out. The property at issue does not belong to the government to give away, and cable operators and conventional cable programmers already have invested billions of dollars in cultivating that property. More importantly, Section 612, which created the commercial leased access obligation, also established that leased access channels should not impose financial hardship on cable operators.[20]

II. THE COMMISSION SHOULD ADOPT NCTA'S PROPOSED APPROACH TO SETTING LEASED ACCESS RATES

TCI remains convinced that the existing "highest implicit fee" ("HIF") formula actually understates the true value of BST and CPST cable channels. TCI is prepared, however, to support the proposal advanced by NCTA to modify the existing approach. In particular, TCI recommends adoption of NCTA's "average channel rate plus markup" approach, coupled with "rate averaging."[21]

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[19] Game Show Comments at 25.

[20] While leased access advocates criticize the current formula for frustrating Congress' desire for a large quantity of leased access activity, the criticism is without foundation -- Congress had ample opportunity to change Section 612's existing rate structure in adopting the Telecommunications Act of 1996 and did not do so. *See* 2A NORMAN J. SINGER, SUTHERLAND STATUTORY CONSTRUCTION, 577-578 (5th ed. 1992) (quoting William Eskridge, *Patterson v. McLean: Interpreting Legislative Inaction*, 87 MICH. L. REV. 67 (1988)).

[21] *See* NCTA Comments at 21-25.

A. **The Commission Should Calculate Commercial Leased Access Rates Based on an Average Channel Formula.**

TCI supports NCTA's "average channel" rate proposal as a sensible modification to the existing HIF formula.[22] Because of the difficulty in precisely measuring the value of any particular cable channel to tier subscribers, TCI agrees that use of the average per channel rate represents a reasonable starting point for the compensation formula. It may not fully compensate the operator for the negative ramifications of converting channel capacity to leased access use, but it at least recognizes the lost subscriber revenue implications of that conversion.

TCI also agrees that the HIF formula, as now formulated, contains a mathematical flaw that favors the cable operator. The formula starts with the average per channel subscriber fee and then reduces that **average** figure by the operator's **lowest** licensing fee. Logic suggests that average revenue should be matched with average cost. Accordingly, TCI supports the proposal to modify the existing HIF formula to create a true "average channel" formula.[23]

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[22]The HIF formula is a misnomer. Instead of identifying the channel with the **highest** value and quantifying its value, the existing formula begins by dividing tier revenue by the number of channels in the tier to produce an **average** channel value.

[23]Premium channels should be calculated separately, as they are at present, using the highest premium penetration level (rather than the average) as the basis for the highest implicit fee calculation because premium channels pose the greatest risk of migration. To ensure sensible rate results, regardless of tier variations in the average per channel rate and the average per channel programming cost, each system's leased access calculation should blend together all BST and CPST offerings to establish a single "average channel" rate.

To ensure the economic adequacy of the "average channel" rate formula, TCI supports NCTA's proposal for a flat 11.25 percent markup. This modest markup would help compensate operators for lost advertising revenue and increased administrative costs.[24] Consistent with the Commission's apparent interest in reducing leased access rates, the average channel rate (including an 11.25 percent markup) would be significantly below the current HIF calculation.

To further promote administrative efficiency, TCI also supports NCTA's suggestion that the Commission allow multiple system operators to establish a company-wide figure for average programming costs. Because most programming affiliation agreements are negotiated at the MSO level, figures from individual systems are likely to closely track the national figure. This "company-wide" option obviously would lighten the administrative burden on cable operators. In addition, by removing the need to review figures on a system-by-system basis, the "company-wide" option would assist leased access applicants and the Commission (as the final adjudicator of leased access disputes).

Simply put, the average channel rate formula is a reasonable surrogate for the admittedly difficult to quantify "opportunity cost" incurred by converting cable channels to leased access use. It has the additional advantage of being relatively simple to apply and review, with little room for artificial manipulation. It does not require detailed rules on the designation of "low value" leased access channels and, therefore, avoids the inherent difficulties of such designations.

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[24]Although arguably an average advertising figure could be added to the formula, establishing average advertising figures on a system-by-system basis could be relatively complicated.

B. The Commission Should Allow Operators to Negotiate Leased Rates Below and Above the Average Leased Access Rate.

TCI strongly supports the concept of "leased access rate averaging" advanced by NCTA.[25] Cable operators should be allowed to negotiate a variety of leased access rates, provided that two conditions are observed: (1) the system's average leased access rate does not exceed the "average channel" rate discussed above; and (2) no leased access service is charged more than the current HIF figure. This approach would enable an operator to meet its aggregate leased access obligation and still maintain different rates based on the relative benefits or burdens a particular service presents for a particular cable system.[26]

Although numerous Commenters argue that cable operators should act like common carriers in the commercial leased access context and not discriminate in pricing,[27] that view does not comport with the statute. Section 612 expressly and unequivocally allows operators to consider content in setting leased access rates. Subsection 612(c)(1)(2) states, "A cable operator . . . may consider [leased access] content to the minimum extent necessary to establish a reasonable price of the commercial use of designated channel capacity by an unaffiliated person." Statutes must be construed to give every provision meaning or

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[25]*See* NCTA Comments at 24-25.

[26]In light of the controversy regarding this issue, TCI restates the request made in its Comments that the Commission (even if it disagrees with the "leased access rate averaging" proposal recommended by NCTA and endorsed by TCI) adopt a regulation *expressly authorizing* cable operators to charge certain leased access programmers less than other leased access programmers.

[27]*See, e.g.,* ValueVision Comments at 13-14; Game Show Comments at 28 (selection of leased access users in high demand situation should be by auction and therefore "content neutral"); Telemiami Comments at 22, 24. *C.f.* Comments of Eternal Word Television Network at 6 (leased access results in common carrier regulation of cable systems and should be deemed unlawful).

purpose,[28] and the only possible purpose this provision could have is to allow cable operators to vary leased access rates based on the nature of the leased access programming and the effect such programming would have on each system's subscribers.

TCI disagrees with Commenters urging a "first come, first served" approach to leasing commercial leased access channels -- at least to the extent the approach would preclude a reasonable upfront evaluation and negotiation period. Even a minor revision to the current leased access formula could trigger the "Oklahoma land rush" predicted by the Game Show Channel. There is no reason to reward those applicants who happen to reach the cable operator first. A far more logical approach would be to allow the operator to negotiate among all interested parties. Accordingly, TCI strongly supports the proposal advanced by NCTA that operators have a six month period (commencing upon receipt of their first leased access request under the revised rules) to reach final carriage agreements with leased access applicants. This brief delay will promote sensible rate averaging and allow cable operators to increase the value and diversity of leased access programming.[29] This approach is far preferable to the creation of artificial categories, rigid quotas, and special discounts proposed

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[28] 3 NORMAN J. SINGER, SUTHERLAND STATUTORY CONSTRUCTION, p. 378-381 (5th ed. 1992) (quoting Stephen Breyer, *On the Uses of Legislative History in Interpreting Statutes*, 65 S. CAL. L. REV. 845 (1992))

[29] The Commission should not fear that the option would stifle viewpoint diversity, as there is no evidence that any of the leased access advocates participating in this proceeding have been discriminated against in any way, least of all based on their viewpoint or ideology. Indeed, the leased access advocates are dominated by shopping, infomercial and "game show" programmers with no identifiable viewpoint or ideology. *See* Time Warner Cable Comments at 2-3 (recent in-house study showed that infomercials were nearly 70 % of commercial leased access on Time Warner systems).

by certain Commenters to accomplish the same end. There is, after all, no logical means for the Commission to establish who is entitled to favorable leased access treatment. The leased access advocates even disagree among themselves as to which users, if any, merit such treatment.[30]

III. THE COMMISSION SHOULD ENSURE ANY DISPUTE RESOLUTION MECHANISM MINIMIZES THE BURDEN ON CABLE OPERATORS AND MAXIMIZES THE PROTECTION OF CONFIDENTIAL INFORMATION.

With certain exceptions and qualifications, the majority of Commenters supported the Commission's proposal to have leased access rate disputes handled initially by independent certified public accountants. TCI supports this approach, but is concerned that some of the suggested changes to the Commission's original proposal could undermine its effectiveness and render the option unacceptable.

First, the Commission should retain its proposal that the outside accountant be selected by the cable operator That selection process will maximize the efficiency and confidentiality of the process, because an operator could designate a single accounting firm to handle all of its leased access disputes. As a result, the underlying documents would not need to be shared among dozens of different accounting firms and a comprehensive analysis

[30] *See, e.g.,* Comments of The Game Show Network, L.P. at 29 ("no persuasive showing" that any non-profits should enjoy preferential rates); Comments of Center for Media Education, *et al.* at 18 (non-profits with tax exempt status should enjoy preference); Comments of Community Broadcasters Association at 10-11(non-profits should not be preferred, but "Congress clearly favors a preference for local program sources generally and LPTV stations in particular").

would not be required every time a new complaint was filed involving the same programming contracts.[31]

Second, the Commission should reject suggestions that cable operators pay for, or automatically share in, the cost of the leased access audit. TCI supports the suggestion that the leased access applicant (the party requesting review) pay for the audit, unless the operator's rate turns out to be more than ten percent greater than legally permitted. The suggested rule reflects a common commercial practice and is certainly appropriate in this context. Without this type of cost assignment, leased access applicants lack the financial incentive to restrain their complaints and could use the complaint mechanism for purposes of harassment. Operators would be forced to defend their leased access rates over and over again, regardless of how reasonable and well-supported the rates might be. TCI submits that this approach is compelled by the statute, which expressly provides, "there shall be a presumption that the price, terms, and conditions for use of channel capacity designated [for commercial leased access] are reasonable and in good faith unless shown by clear and convincing evidence to the contrary." 47 U.S.C. § 532(f). Congress clearly and deliberately placed the burden of proof on the leased access applicant.

CONCLUSION

The evidence in this proceeding shows that carriage of leased access programming could have significant negative ramifications on subscriber satisfaction. The

[31]Any appeal of the accountant's evaluation should go directly to the Commission and should in no way require the disclosure of confidential cost information included in conventional programming contracts to competing leased access programmers.

leased access rate formula must compensate cable operators accordingly. The "average channel" rate formula is the best option available to accomplish this objective. The Commission must not forget Congress' instruction that leased access terms should be "**at least** sufficient to assure that such [leased access] use will not adversely affect the operation, financial condition, or market development of the cable system."

Respectfully submitted,

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